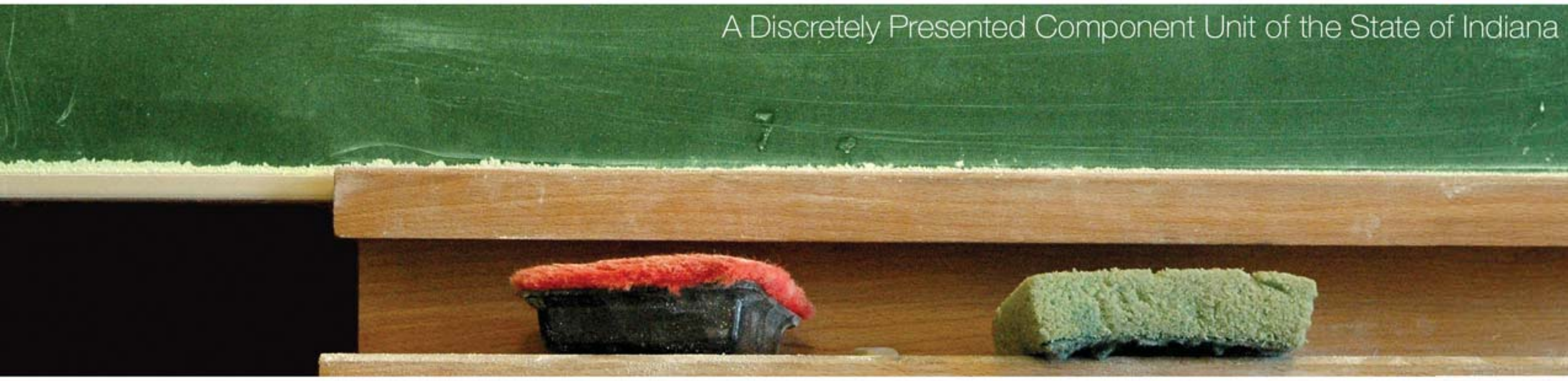
# Indiana State Teachers' Retirement Fund

A Discretely Presented Component Unit of the State of Indiana



# 2008 Comprehensive Annual Financial Report

Building Your Retirement Future

For the Fiscal Year Ended June 30, 2008

# Indiana State Teachers' Retirement Fund

# 2008 Comprehensive Annual Financial Report


**PREPARED BY**
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*Building Your Retirement Future*

TRF

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# Introduction

## Letter of Transmittal

Steve Russo
*Executive Director*

December 2008
Dear Board Members:

We are pleased to present the Comprehensive Annual Financial Report (CAFR) of the Indiana State Teachers' Retirement Fund (TRF) for the fiscal year ended June 30, 2008.

### About the Indiana State Teachers' Retirement Fund (TRF)

The Indiana General Assembly created the Indiana State Teachers' Retirement Fund (TRF) in 1921 as a "pay-as-you-go" defined benefit (DB) retirement system to provide pension and disability benefits to its members and/or their beneficiaries. Pay-as-you-go means that the State decided not to pre-fund the teachers' retirements through employee and employer contributions while the members were actively teaching. Instead, the State decided to appropriate money for the retirement benefits as they became due for payment. Upon reaching age and service eligibility requirements, members are entitled to a monthly DB pension payment based in part upon a formula that takes into account the member's age, years of service, and the average of the member's highest five years of salary.

Since its establishment in 1921, the laws governing the administration of TRF have changed and expanded in response to the needs of our members, employers, and citizens. In 1955, legislation added a defined contribution (DC) element to the benefit, known as the Annuity Savings Account (ASA). This benefit is funded by a 3% member contribution; however, by statute, employers are allowed to make the 3% contribution on behalf of the member. Members are immediately vested in their Annuity Savings Accounts. Upon retirement, members can withdraw their ASA balances in lump sums or they can convert their balances into annuitized amounts that are added to the monthly defined benefit.

The 1995 legislative session brought several significant changes to TRF. Legislation was passed that closed the pay-as-you-go plan (named the Pre-1996 Account) to newly hired members and created a new account named the 1996 Account. All teachers hired after June 30, 1995 would be members of the 1996 Account. This account was established to be actuarially pre-funded by requiring school corporations to set aside a fixed percentage of payroll for teacher retirements. Also in 1995, the general assembly passed legislation creating the Pension Stabilization Fund (PSF), designed to partially fund TRF's unfunded liability of the Pre-1996 Account. The PSF was initially funded from $425 million of employer reserves from the Pre-1996 Account and, since that time, has received contributions from the Indiana State General Fund and the Indiana State Lottery, as well as interest earned from the investment of PSF assets. As of June 30, 2008, TRF's combined net assets had a market value of $8.6 billion, of which $2.0 billion resides in the PSF.

In 2001, legislation established that TRF was no longer to be a state agency but an "independent body corporate and politic", often called a "quasi-state agency". Though TRF is under the authority of the governor and the Office of Management and

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**Fax: (317) 233-0914**

Budget (OMB), it is not under the jurisdiction or authority of the State Personnel Department or the Department of Administration. By Executive Order of the Governor, the Fund is under the jurisdiction of the State Ethics Commission.

Indiana Code establishes a six-member Board of Trustees to oversee TRF. Five trustees, two of whom must be Indiana educators and members of the Fund, are appointed by the governor. The sixth member of the Board must be a director of the budget agency or the director's designee. An executive director appointed by the governor carries out the policies set by the Board and administers the Fund on a daily basis. In support of the Board and the executive director, TRF employed 46 full-time staff members as of June 30, 2008.

The Fund serves approximately 160,000 members and 390 employers. TRF provides a monthly benefit to over 41,000 retirees and maintains accounts for approximately 76,000 active members and 43,000 inactive members. Details about the demographics of TRF members can be found in the Statistical Section of this report.

## Benefit Plan and Other Legislative Changes during Fiscal Year 2008

There were several changes that took effect during fiscal year 2008.

- **Sudan Divestment –** Legislation established a process and timeline for TRF to divest from companies with certain business activities in Sudan.

- **Cost of Living Adjustment (COLA) –** This legislation provided a 2% increase to members who retired before July 2, 1999 and provided a 1% increase to members who retired after July 1, 1999 and before July 2, 2005. The effective date of the COLA was January 1, 2008.

- **Reemployment After Retirement –** Effective July 1, 2007, legislation was passed that removed the earnings limitation for a member who reemploys more than 90 days after the member's retirement in a covered position. During the period of reemployment, it provides that the member does not earn creditable service in TRF and is not entitled to an additional benefit.

- **Changing Beneficiaries After Divorce –** Effective July 1, 2007, this legislation allows a member who is receiving a TRF benefit to elect, under certain conditions of divorce, to change the member's designated beneficiary or form of benefit.

## Management's Responsibility for Financial Reporting

TRF's management is responsible for the contents of this report and is responsible for establishing and maintaining a system of adequate internal accounting controls designed to provide reasonable assurance that transactions are executed in accordance with management's general or specific authorization. TRF's management is also charged with recording these transactions as necessary to maintain accountability for assets and to permit preparation of financial statements in accordance with generally accepted accounting principles. This system includes the written policies and procedures of the Board of Trustees.

For financial reporting purposes, TRF follows Governmental Accounting Standards Board (GASB) Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans. Assets of TRF are presented at fair value. The actuarial value of assets and the actuarial accrued liability are presented in the Required Supplemental Schedules following the Notes to the Financial Statements.

GASB issued Statement No. 34, Basic Financial Statements - and Management's Discussion and Analysis – for State and Local Governments. This statement establishes financial reporting standards for state and local governments. The Management's Discussion and Analysis is contained within the Financial Section of this report and serves to supplement the Introductory Section of this CAFR, as well as Financial Statements, Notes to the Financial Statements, and Required Supplemental Schedules within the Financial Section.

## Economic Condition

TRF's economic condition is based primarily upon appropriations from the Indiana State General Assembly, contributions from members and employers, and investment results. In fiscal year 2008, the State of Indiana maintained a balanced budget and was able to provide an added level of confidence that the State could meet its funding obligations to the TRF Pre-1996 Account. The State also repaid all outstanding debts to Indiana school corporations, thus providing an added level of assurance that school corporations could meet their obligations to pay required employer contributions to the TRF 1996 Account. In fiscal year 2008, TRF received all required appropriations from the State of Indiana and received all required contributions from members and employers. The impact of economic conditions on TRF's investments was evaluated by Callan Associates Inc., TRF's primary investment management consultant. Callan's report can be found in the Investments Section of this report.

## Investments

TRF continues to invest in a mix of asset classes that allow the Fund to benefit in periods of rising equities markets while moderating the risks on the downside. Fiscal year 2008 was a period in which the Fund mitigated the double digit declines in the global equities markets. Investment gains in the fixed income and the alternative investments portion of the portfolio helped to offset a portion of the equities losses. The Fund's investment portfolio is comprised of both DB and DC assets. Combined, the investment return for the fiscal year was -4.2%, as compared to US Equity S&P 500 index of -13.1% and the International MSCI EAFE Index of -6.2%.

Another common measure of investment performance is to compare a portfolio's actual return to its benchmark return. TRF's investment performance was not only better than the target benchmark for fiscal year 2008, but it remains better than the benchmark return over the past five-year period.

Detailed investment policies and performance results can be found in the Investments Section of this report.

## Asset Allocation

Prudent diversification through strategic asset allocation is fundamental to the Board of Trustees' overall investment policy. The policy is designed to provide an optimal mix of asset classes in order to meet TRF's return objectives while maintaining appropriate diversification and risk control. TRF continues to incorporate traditional assets (cash, domestic and international stocks, and domestic fixed income) while also incorporating nontraditional assets (real estate, absolute return, and private equity) into the target asset mix.

The investment portfolio mix at fair value for the fiscal year ending June 30, 2008 was approximately 23.4% fixed income, 60.3% equities, and 16.3% alternative investments. This fiscal year also saw the actual allocation of assets within the targeted range for each asset class as approved by the TRF Board of Trustees.

## Funding

An actuarial analysis of TRF is performed on an annual basis. An assumption experience study is performed every three to five years and the most recent experience study was completed in fiscal year 2008. The actuarial firm, Alliance Benefit Group, completed the most recent annual actuarial analysis. One of the purposes of the actuarial analysis is to measure the funding status, typically referred to as the funded percentage. The percentage is computed by dividing the actuarial value of net assets by the actuarial accrued liability. This ratio provides an indication of the funding status of the plan and, generally, the greater this percentage, the stronger the plan.

As discussed earlier, TRF is one fund comprised of two separate accounts, the Pre-1996 Account and the 1996 Account. Each of these accounts is funded differently. Given that the Pre-1996 Account is funded on a pay-as-you-go basis from the State of Indiana, the funded percentage measurement is not as meaningful in measuring the strength of this account.

However, the application of the funded percentage to the 1996 Account is more meaningful, as this account is actuarially pre-funded by contributions from members and employers. The funded percentage of the 1996 Account is a very healthy 95.9%. Another purpose of the actuarial analysis is to guide the Board of Trustees in the determination of the required contribution rate as a percent of payroll from employers. In fiscal year 2008, the required DB contribution rate from employers for members in the 1996 Account was 7.25% of payroll.

Details of the actuarial analysis can be found in the Actuarial Section of the report. Supporting statistics can be found in the Statistical Section. In the Statement of Changes in Fiduciary Net Assets, contained in the Financial Section of this report, the accumulated balance of funds derived from the excess of additions over deductions is referred to as the net assets held in trust for pension benefits. The actuarial accrued liability is not disclosed in the Financial Statements but is disclosed in the Required Supplemental Schedules following the Notes to the Financial Statements.

## Accomplishments in 2008

TRF has continued its pursuit of excellence throughout fiscal year 2008. TRF's commitment to outstanding customer service was demonstrated by the implementation of operational programs that now have 95%+ of new retirees receiving their first pension payment on time. Disbursement of requested ASA refunds is now taking place on a weekly basis. A communications and outreach department was established to significantly improve retirement education for members.

Significant strides were achieved in the implementation of new information technologies. For the first time in TRF's history, 100% of data reporting from employers was conducted electronically. Several enhancements to the TRF Web site were implemented. TRF also established a long range information technology plan to guide significant operational and customer service improvements in the coming years.

## Acknowledgements

The compilation of this report reflects the combined efforts of TRF staff and advisors. It is intended to demonstrate the spirit of full disclosure and to provide information for use as the basis for making management decisions, as a means of determining compliance with legal provisions, and as a means of determining responsible stewardship of the assets contributed by our members and employers.

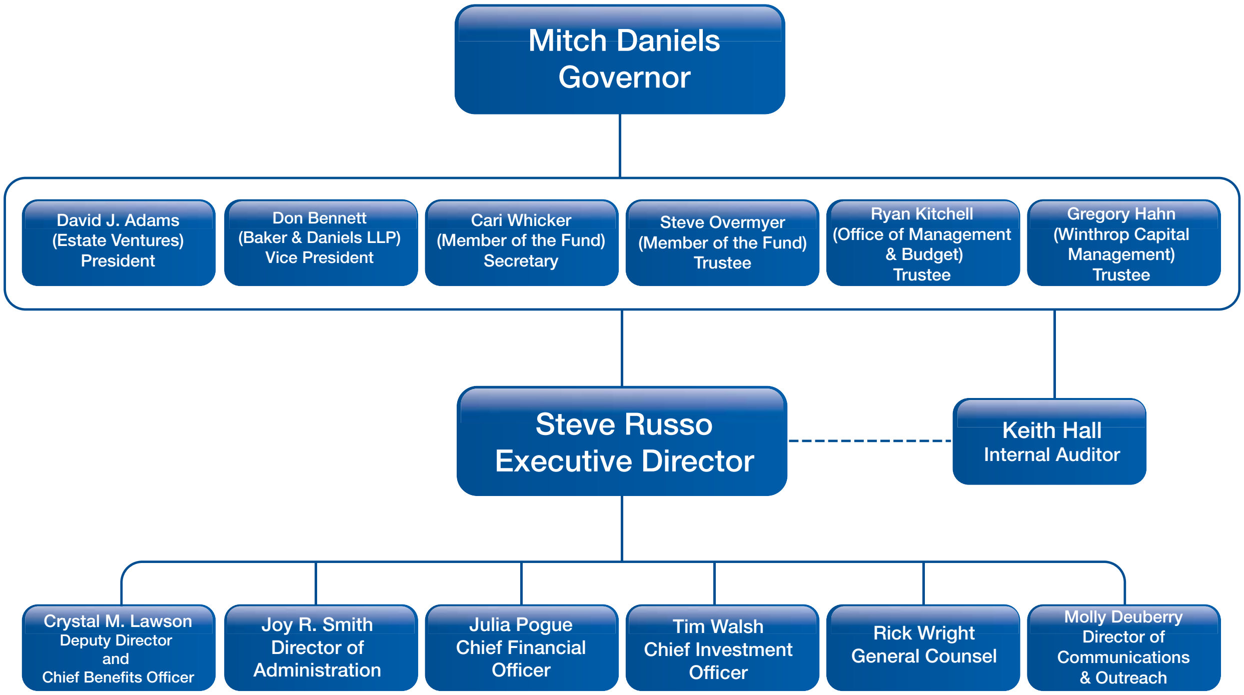
We express our gratitude to the staff, advisors, and all who have contributed to the preparation of this report. We also thank Cristy Wheeler, who served as TRF's Executive Director through the first eight months of the fiscal year.

The TRF staff also wishes to express our gratitude to Indiana Governor Mitch Daniels, the Indiana General Assembly, members of the Indiana Pension Management Oversight Commission, and the TRF Board of Trustees who provided TRF staff the privilege of serving the needs of our members and employers.

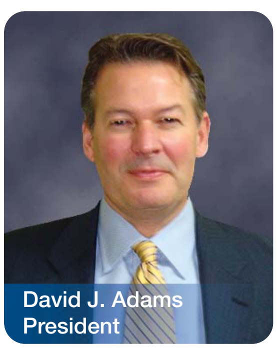
Sincerely,

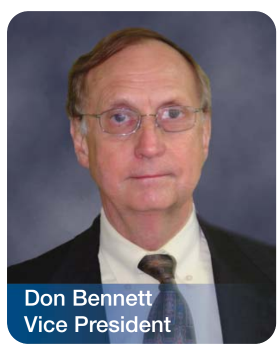
Steve Russo
Executive Director

# Organization Chart

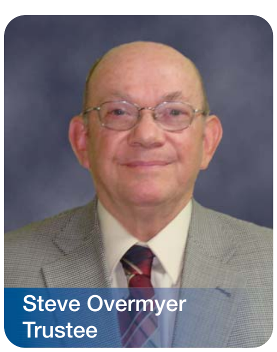



# Board of Trustees



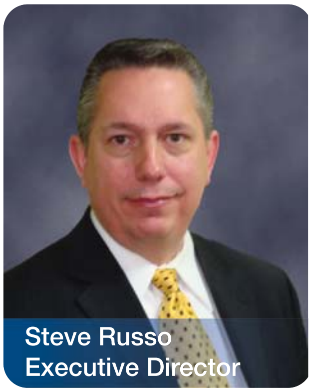





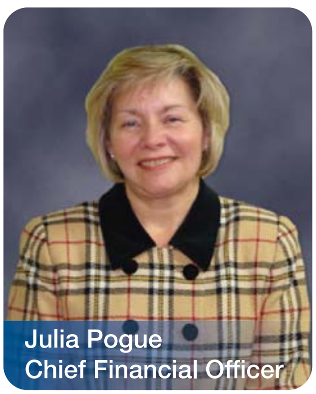




# Executive Team


Steve Russo
Executive Director


Crystal M. Lawson
Deputy Director
Chief Benefits Officer


Julia Pogue
Chief Financial Officer


Tim Walsh
Chief Investment Officer


Joy R. Smith
Director of Administration


Rick Wright
General Counsel


Molly Deuberry
Director of Communications
and Outreach


Keith Hall
Internal Auditor

**Mitch Daniels**
Governor
**Becky Skillman**
Lt. Governor

## Administrative Staff

**Steve Russo**
Executive Director
**Crystal M. Lawson**
Deputy Director and
Chief Benefits Officer
**Julia Pogue**
Chief Financial Officer
**Tim Walsh**
Chief Investment Officer
**Joy R. Smith**
Director of Administration
**Rick Wright**
General Counsel
**Molly Deuberry**
Director of Communications
and Outreach
**Keith Hall**
Internal Auditor

## Professional Consultants

**Ice Miller**
One American Square
Suite 2900
Indianapolis, IN 46282
**Kreig Devault LLP**
One Indiana Square
Suite 2800
Indianapolis, IN 46204
**KPMG**
303 East Wacker Drive
Chicago, IL 60601
**Alliance Benefit Group**
9320 Priority Way West Dr
Indianapolis, IN 46240

*A list of investment professionals can be found on page 55.*

## Membership and Eligibility

The Indiana State Teachers' Retirement Fund includes eligible educators and administrators.

### Members Receiving Retirement Benefits

| Age | Years of Service | Allowance Reduction |
|---|---|---|
| 50 up to 59 | 15 or more | 11% at age 59, additional 5% for each year under age 59 |
| 55 | Age at retirement plus total years of service equals 85 or more | None |
| 60 | 15 or more | None |
| 65 | 10 or more | None |

### Benefit Formula

Annual Benefit =

(Average of Highest 5 Years of Annual Compensation x Total Years of Service x 1.1% (0.011))

+

Annuity Savings Account[1]

*[1]At retirement, a member can elect to receive the Annuity Savings Account as a monthly supplement to the defined pension benefit or in a total distribution.*

### Cost of Living Adjustments (COLA)

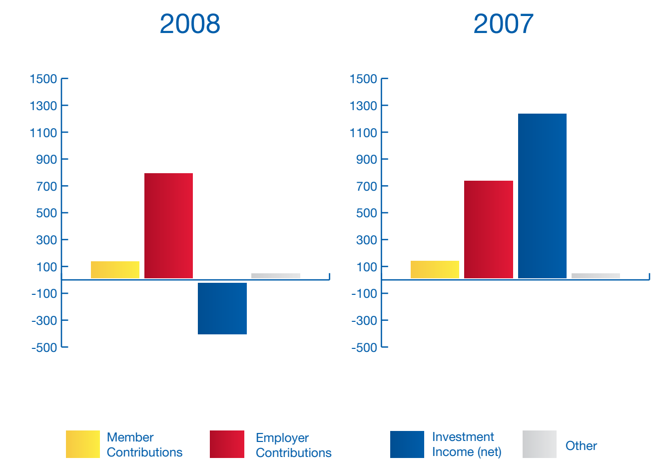
Cost of living adjustments are passed by the Indiana General Assembly on an ad-hoc basis.

### Contribution Rates

- Members are required to contribute 3% of gross wages to their Annuity Savings Accounts. Employers have the option of making all or part of this 3% contribution on behalf of the member.
- Members may also voluntarily contribute up to an additional 10% of their wages into their Annuity Savings Accounts.
- The amount (rate) of employer contributions in the 1996 Account is adopted by the Board of Trustees based on recommendations by the Indiana State Teachers' Retirement Fund's actuary.

## Additions by Source

For fiscal year ended June 30 (in millions)

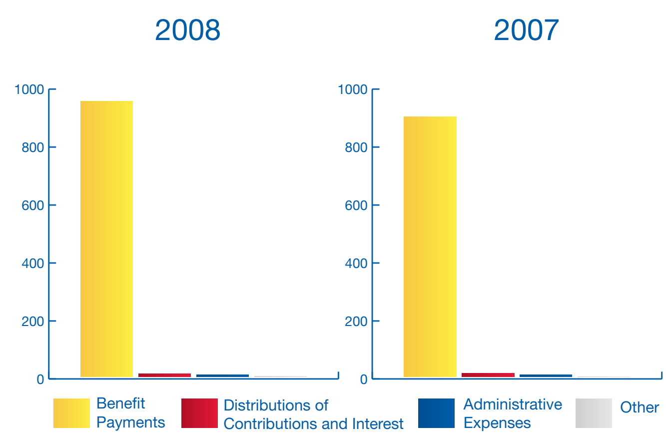



### Additions by Source

| For fiscal year ended June 30 (in millions) | 2008 | 2007 |
|---|---|---|
| Member Contributions | $ 123.9 | $ 126.2 |
| Employer Contributions | 778.1 | 723.0 |
| Investment Income (net) | (381.1) | 1,223.4 |
| Other | 33.2 | 33.9 |
| Total | $554.1 | $2,106.5 |

## Deductions by Type

For fiscal year ended June 30 (in millions)

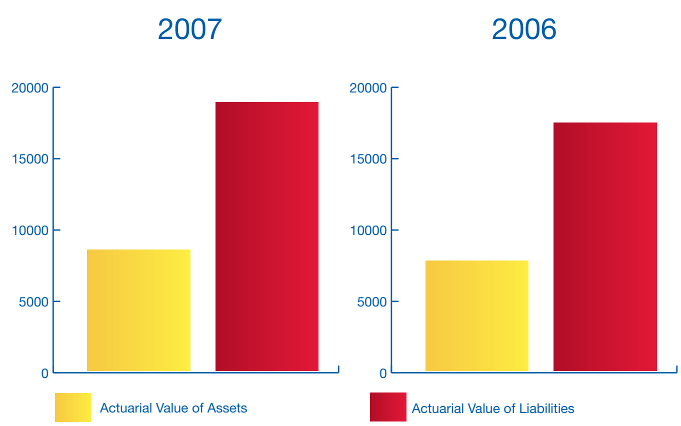



### Deductions by Type

| For fiscal year ended June 30 (in millions) | 2008 | 2007 |
|---|---|---|
| Benefit Payments | $ 950.9 | $ 897.6 |
| Distributions of Contributions and Interest | 10.5 | 12.9 |
| Administrative Expenses | 6.9 | 6.5 |
| Other | 2.7 | 0.1 |
| Total | $ 971.0 | $ 917.1 |

## Funding Progress

Actuarial study as of July 1 (in millions)




### Funding Progress

| Actuarial study as of July 1 (in millions, with ratios) | 2007 | 2006 |
|---|---|---|
| Actuarial Value of Assets | $8,476.6 | $7,686.7 |
| Actuarial Value of Liabilities | 18,815.8 | 17,365.5 |
| Funding Ratios | 45% | 44% |